# Outline Study on Economic Inflation its Types and Stages – An Analysis

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**Abstract**

This paper attempts to study how currently, a great deal of popular attention is being paid to issues relating to inflation and its measurement in India, than ever before, reflecting some new realities. First, with the dismantling of most administered interest-rates, the link between inflation and interest rate is, relative to the past, more closely tracked by savers, investors and financial intermediaries. True, in the past also, there were links, more in the case of deposit rates than lending rates, but in the recent past, there is greater sensitivity to the link. Second, with the progressive opening up of the economy, the integral link between inter-country interest rate differentials, inflation rate differentials and the forward exchange premia are closely observed when viewing exchange rate movements. Third, in a liberalised trading regime and market determined exchange rate regime, and also if the country has to allow the economy to be "globalised" or more open, inflation-tracking is critical in terms of maintaining competitiveness of domestic industry. Fourth, the market participants carefully track inflation data to anticipate and assess monetary policy changes, in view of the recent trends in the manner of articulation of such policy changes. At the outset, it would be useful to clarify the headline measure of inflation in India. This will be followed by a review of inflation in India from the 1950s to the present times. The measurement issues, with special reference to the recently observed widening of divergence between the two frequently used measures of inflation in India would be elaborated. Then the discussion would turn to the concept of core inflation and its relevance to India. Some exploratory analysis is attempted on the apparent puzzle of the current low inflation being accompanied by relatively high growth in money supply. The dilemmas in monetary policy in the context of inflation will be referred to before giving a comprehensive treatment to the relevance of inflation targeting in our country.

*Key words:* ***Inflation*** *, Demand-Pull, Cost-Push , Built-in* ***inflation****, monetary policy, RBI*

## Introduction

The various beneficial effects of globalization in Indian Industry are that it brought in huge amounts of foreign investments into the industry especially in the BPO, pharmaceutical, petroleum, and manufacturing industries. As huge amounts of foreign direct investments (FDI) were coming to the Indian Industry, they boosted the Indian economy quite significantly. The benefits of the effects of globalization in the Indian Industry are that many foreign companies set up industries in India, especially in the pharmaceutical, BPO, petroleum, manufacturing, and chemical sectors and this helped to provide employment to many people in the country. This helped reduce the level of unemployment and poverty in the country. Also the benefit of the Effects of Globalization on Indian Industry are that the foreign companies brought in highly advanced technology with them and this helped to make the Indian Industry more technologically advanced.The various negative Effects of Globalization on Indian Industry are that it increased competition in the Indian market between the foreign companies and domestic companies. With the foreign goods being better than the Indian goods, the consumer preferred to buy the foreign goods. This reduced the amount of profit of the Indian Industry companies. This happened mainly in the pharmaceutical, manufacturing, chemical, and steel industries. The negative Effects of Globalization on Indian Industry are that with the coming of technology the number of labor

required decreased and this resulted in many people being removed from their jobs. This happened mainly in the pharmaceutical, chemical, manufacturing, and cement industries. The effects of globalization on Indian Industry have proved to be positive as well as negative. The government of India must try to make such economic policies with regard to Indian Industry's Globalization that are beneficial and not harmful. Indian government did the same and liberalized the trade and investment due to the pressure from World Trade Organization. Import duties were cut down phase-wise to allow MNC's operate in India on equality basis. As a result globalization has brought to India new technologies, new products and also the economic opportunities. Despite bureaucracy, lack of infrastructure, and an ambiguous policy framework that adversely impact MNCs operating in India, MNCs are looking at India in a big way, and are making huge investments to set up R&D centers in the country. India has made a lead over other growing economies for IT, business processing, and R&D investments. There have been both positive and negative impacts of globalization on social and cultural values in India.

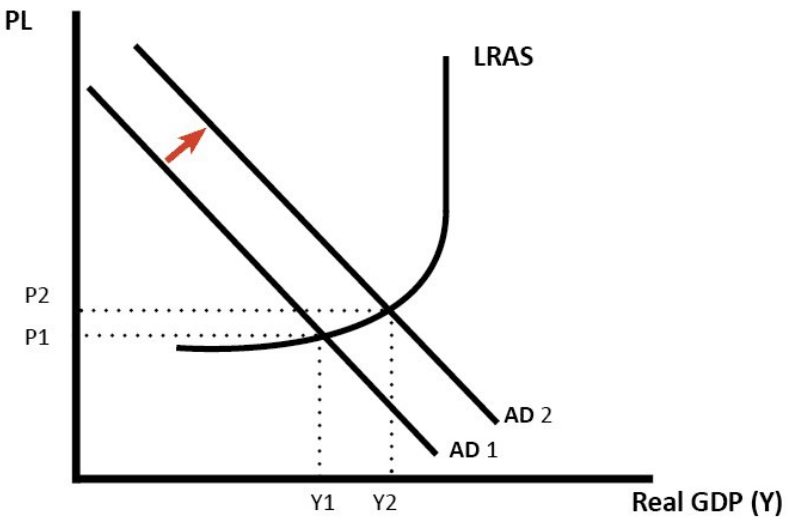
**Objective:**

This paper intends to explore and analyze the **Inflationary** pressure which is decline of purchasing power of a given currency over time. A quantitative estimate of the rate at which the decline in purchasing power. Also, the **types of Inflation**: On the basis of the rate of increase in price with multiple **stages** .

**1. Demand-pull inflation**

This occurs when AD increases at a faster rate than AS. Demand pull inflation will typically occur when the economy is growing faster than the long run trend rate of growth. If demand exceeds supply, firms will respond by pushing up prices.

**Simple diagram showing demand pull inflation**



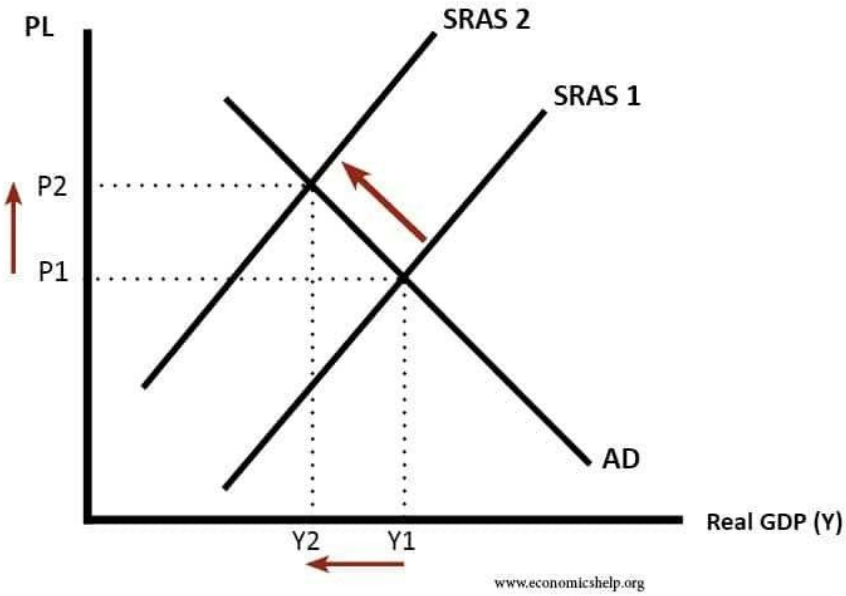

The India experienced demand-pull inflation during the Lawson boom of the late 1980s. Fuelled by rising house prices, high consumer confidence and tax cuts, the economy was growing by 5% a year, but this caused supply bottlenecks and firms responded by putting up prices. Therefore the inflation rate crept up.

This graph shows inflation and economic growth in the India during the 1980s. High growth in 1987, 1988 of 4-5% caused an increase in the inflation rate. It was only when the economy went into recession in 1990 and 1991, that we saw a fall in the inflation rate. See: Demand-pull inflation.

**2. Cost-push inflation**

This occurs when there is an increase in the cost of production for firms causing aggregate supply to shift to the left. Cost-push inflation could be caused by rising energy and commodity prices. See also: Cost Push Inflation

**Diagram showing cost-push inflation.**




In early 2008, the India economy entered a deep recession(GDP fell 6%). However, at the same time, we experienced a rise in inflation. This inflation was definitely not due to demand-side factors; it was due to cost push factors, such as rising oil prices, rising taxes and rising import prices (as a result of depreciation in the Pound) By 2013, cost-push factors had mostly disappeared and inflation had fallen back to its target of 2%. After the June 2016 Brexit referendum, Sterling fell another 13% causing another period of cost-push inflation in 2017.

Sometimes cost-push inflation is known as the 'wrong type of inflation' because this inflation is associated with falling living standards. It is hard for the Central Bank to deal with cost push inflation because they face both inflation and falling output.

**3. Wage Push Inflation**

Rising wages tend to cause inflation. In effect, this is a combination of demand pull and cost push inflation. Rising wages increase costs for firms, and so these are passed onto consumers in the form of higher prices. Also rising wages give consumers greater disposable income and therefore cause increased consumption and AD. In the 1970s, trades unions were powerful in the India. This helped cause rising nominal wages; this was a significant factor in causing inflation of the 1970s.

**4. Imported Inflation**

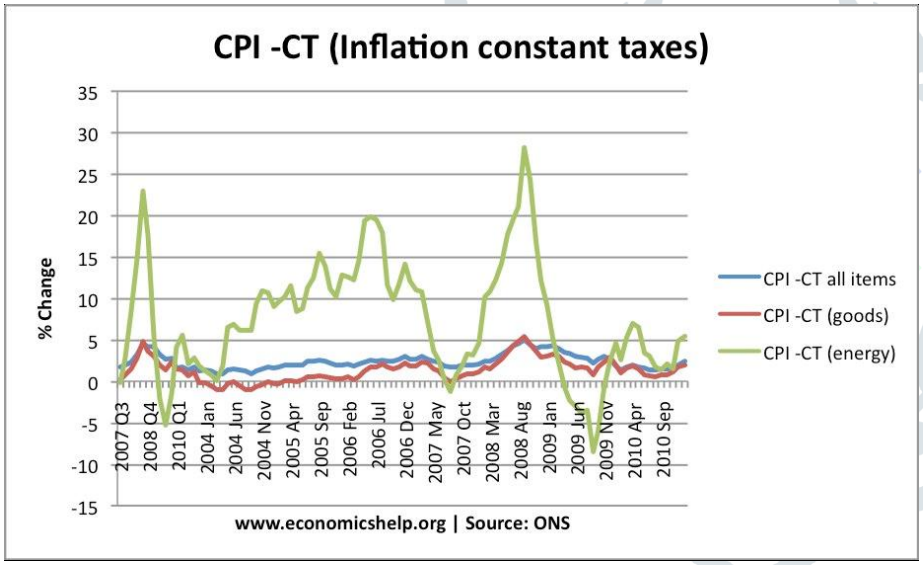
A depreciation in the exchange rate will make imports more expensive. Therefore, the prices will increase solely due to this exchange rate effect. A depreciation will also make exports more competitive so will increase demand.

**5. Temporary Factors**

The inflation rate can also increase due to temporary factors such as increasing indirect taxes. If you increase VAT rate from 17.5% to 20%, all goods which are VAT applicable will be 2.5% more expensive. However, this price rise will only last a year. It is not a permanent effect.

**Core Inflation**

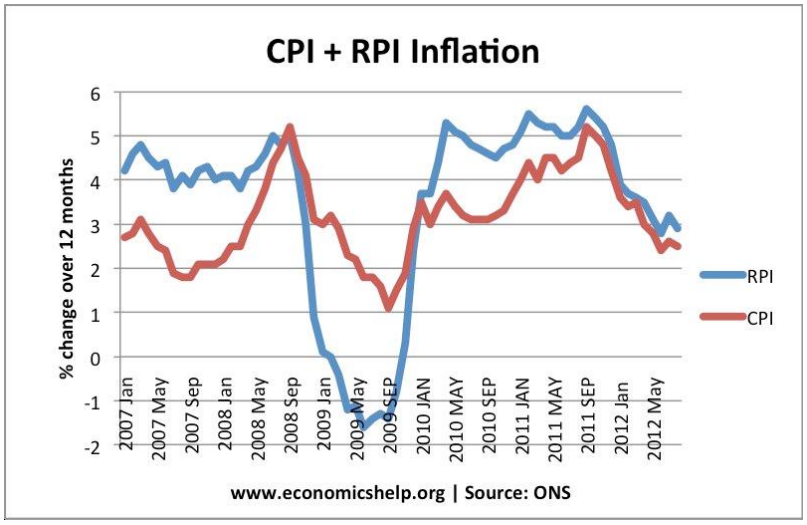
One measure of inflation is known as 'core inflation' This is the inflation rate that excludes temporary 'volatile' factors, such as energy and food prices. The graph below shows inflation in the EU. The headline inflation rate (HICP) is more volatile rising to 4% in 2008 and then falling to -0.5% in 2009. However, the core inflation (HCIP – energy, food, alcohol and tobacco) is more constant.



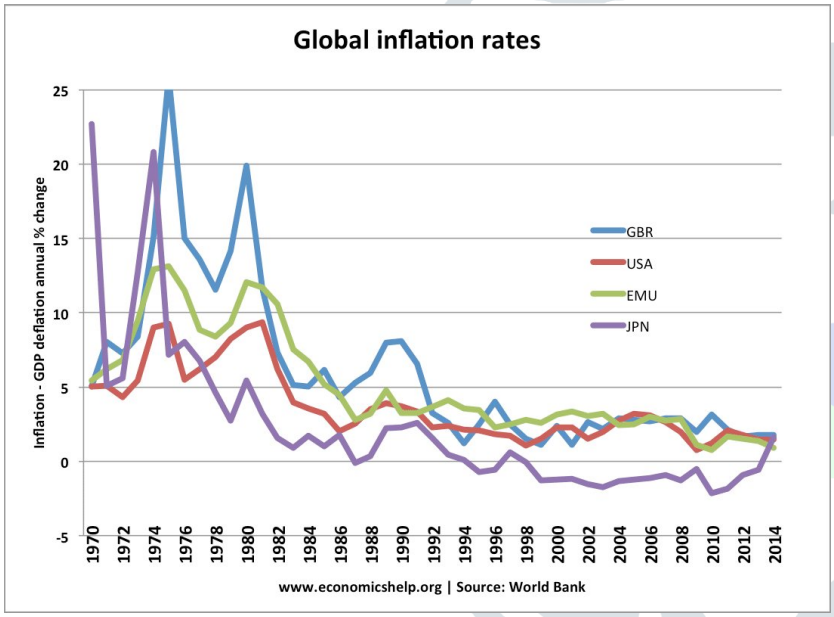

This shows that energy prices were very volatile in this period, contributing to cost-push inflation in 2008.

**Different measures of inflation**

There are different measures of inflation. RPI includes mortgage interest payments. In 2009, interest rates were cut, therefore, RPI measure of inflation became negative. CPI excludes the effect of mortgage interest payments. The ONS now produce a statistic CPIH, which is CPI – owner occupier costs.




**Global inflation**




Inflation tends to be global. In the 1970s, rising oil prices caused inflation in most major economies. Since the 1990s, inflation has fallen across the world.

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**Review of Inflationary Trends in India**

In general, among the developing countries, India's inflation performance would be considered as satisfactory, as would be evident from the study already mentioned. During the fifties, in fact, the average decadal rate of inflation was very low at 1.7 per cent, with the rate varying in a wide range from a negative value of 12.5 per cent to a positive value of 13.8 per cent. The minimum inflation at a negative rate in 1952-53 was in response to the bumper agricultural production in that year while the maximum inflation rate in 1956-57 was mainly attributed to demand pressures, especially investment demand, both public and private.

**Conclusion**

The transmission-mechanisms are being enhanced but serious rigidities such as the interest-rates for Provident Funds, administered small-savings etc. persist. Liberalisation of various markets, including agricultural markets cut into rent-margin in commodities. Fiscal policy would be relevant not only in terms of aggregate demand effects through direct and indirect monetisation, but also because of changing composition of tax and expenditure-structureInflation, as a subject, has been a major area of economic-research and public-debate, all over the world, and particularly so in India, where strong democratic traditions and intellectuals' activism are well rooted. Even so, it may be appropriate to highlight some of the areas that need attention at this juncture. It is well recognised that, viewed in the light of the experience of the recent past, the year 1998-99 saw high inflation rates in most months. In analysing inflation, we need also to look at the asset price inflation, particularly in the context of financial market liberalisation. In India, the asset prices are not covered in both the indices of inflation indicators despite their increasing importance in terms of one of the important channels for the transmission mechanism of monetary policy. However, there are significant difficulties in constructing an appropriate index for this purpose.

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